

(c) *Code*. For purposes of this part, the term “Code” means the Internal Revenue Code of 1954, as amended.

### § 3.2 Ceiling on deposits.

(a) *In general*—(1) *Total ceiling*. Section 607(b) of the Act provides a ceiling on the amount which may be deposited by a party for a taxable year pursuant to an agreement. The amount which a party may deposit into a fund may not exceed the sum of the following subceilings:

(i) The lower of (a) the taxable income (if any) of the party for such year (computed as provided in Chapter I of the Code but without regard to the carryback of any net operating loss or net capital loss and without regard to section 607 of the Act) or (b) taxable income (if any) of such party for such year attributable under paragraph (b) of this section to the operation of agreement vessels (as defined in paragraph (f) of this section) in the foreign or domestic commerce of the United States or in the fisheries of the United States (see section 607(b)(1)(A) of the Act).

(ii) Amounts allowable as a deduction under section 167 of the Code for such year with respect to the agreement vessels (see section 607(b)(1)(B) of the Act),

(iii) The net proceeds (if not included in subdivision (i) of this paragraph) from (a) the sale or other disposition of any agreement vessels or (b) insurance or indemnity attributable to any agreement vessels (see section 607(b)(1)(C) of the Act and paragraph (c) of this section), and

(iv) Earnings and gains from the investment or reinvestment of amounts held in such fund (see section 607(b)(1)(D) of the Act and paragraphs (d) and (g) of this section).

(2) *Overdeposits*. (i) If for any taxable year an amount is deposited into the fund under a subceiling computed under subparagraph (1) of this paragraph which is in excess of the amount of such subceiling for such year, then at the party's option such excess (or any portion thereof) may—

(a) Be treated as a deposit into the fund for that taxable year under another available subceiling, or

(b) Be treated as not having been deposited for the taxable year and thus, at the party's option, may be disposed of either by it being—

(1) Treated as a deposit into the fund under any subceiling available in the first subsequent taxable year in which a subceiling is available, in which case such amount shall be deemed to have been deposited on the first day of such subsequent taxable year, or

(2) Repaid to the party from the fund.

(ii)(a) When a correction is made for an overdeposit, proper adjustment shall be made with respect to all items for all taxable years affected by the overdeposit, such as, for example, amounts in each account described in § 3.4, treatment of nonqualified withdrawals, the consequences of qualified withdrawals and the treatment of losses realized or treated as realized by the fund. Thus, for example, if the party chooses to have the fund repay to him the amount of an overdeposit, amounts in each account, basis of assets, and any affected item will be determined as though no deposit and repayment had been made. Accordingly, in such a case, if there are insufficient amounts in an account to cover a repayment of an overdeposit (as determined before correcting the overdeposit), and the party had applied the proceeds of a qualified withdrawal from such account towards the purchase of a qualified vessel (within the meaning of § 3.11(a)(2)), then such account and the basis of the vessel shall be adjusted as of the time such withdrawal was made and proceeds were applied, and repayment shall be made from such account as adjusted. If a party chooses to treat the amount of an overdeposit as a deposit under a subceiling for a subsequent year, similar adjustments to affected items shall be made. If the amount of a withdrawal would have exceeded the amount in the fund (determined after adjusting all affected amounts by reason of correcting the overdeposit), the withdrawal to the extent of such excess shall be treated as a repayment made at the time the withdrawal was made.

(b) If the accounts (as defined in § 3.4) that were increased by reason of excessive deposits contain sufficient amounts at the time the overdeposit is

discovered to repay the party, the party may, at his option, demand repayment of such excessive deposits from such accounts in lieu of making the adjustments required by (a) of this subdivision (ii).

(iii) During the period beginning with the day after the date an overdeposit was actually made and ending with the date it was disposed of in accordance with subdivision (i)(b) of this subparagraph, there shall be included in the party's gross income for each taxable year the earnings attributed to any amount of overdeposit on hand during such a year. The earnings attributable to any amount of overdeposit on hand during a taxable year shall be an amount equal to the product of—

(a) The average daily earnings for each one dollar in the fund (as determined in subdivision (iv) of this subparagraph),

(b) The amount of overdeposit (as determined in subdivision (vi) of this subparagraph), and

(c) The number of days during the taxable year the overdeposit existed.

(iv) For purposes of subdivision (iii) (a) of this subparagraph, the average daily earnings for each dollar in the fund shall be determined by dividing the total earnings of the fund for the taxable year by the sum of the products of—

(a) Any amount on hand during the taxable year (determined under subdivision (v) of this subparagraph), and

(b) The number of days during the taxable year such amount was on hand in the fund.

(v) For purposes of this subparagraph—

(a) An amount on hand in the fund or an overdeposit shall not be treated as on hand on the day deposited but shall be treated as on hand on the day withdrawn, and

(b) The fair market value of such amounts on hand for purposes of this subparagraph shall be determined as provided in §20.2031-2 of the Estate Tax Regulations of this chapter but without applying the blockage and other special rules contained in paragraph (e) thereof.

(vi) For purposes of subdivision (iii) (b) of this subparagraph, the amount of

overdeposit on hand at any time is an amount equal to—

(a) The amount deposited into the fund under a subceiling computed under subparagraph (1) of this paragraph which is in excess of the amount of such subceiling, less

(b) The sum of—

(1) Amounts described in (a) of this subdivision (vi) treated as a deposit under another subceiling for the taxable year pursuant to subdivision (i) of this subparagraph,

(2) Amounts described in (a) of this subdivision (vi) disposed of (or treated as disposed of) in accordance with subdivision (i) or (ii) of this subparagraph prior to such time.

(vii) To the extent earnings attributed under subdivision (iii) of this subparagraph represent a deposit for any taxable year in excess of the subceiling described in subparagraph (1)(iv) of this paragraph for receipts from the investment or reinvestment of amounts held in the fund, such attributed earnings shall be subject to the rules of this subparagraph for overdeposits.

(3) *Underdeposit caused by audit adjustment.* [Reserved]

(4) *Requirements for deficiency deposits.* [Reserved]

(b) *Taxable income attributable to the operation of an agreement vessel—*(1) *In general.* For purposes of this section, taxable income attributable to the operation of an agreement vessel means the amount, if any, by which the gross income of a party for the taxable year from the operation of an agreement vessel (as defined in paragraph (f) of this section) exceeds the allowable deductions allocable to such operation (as determined under subparagraph (3) of this paragraph). The term “taxable income attributable to the operation of the agreement vessels” means the sum of the amounts described in the preceding sentence separately computed with respect to each agreement vessel (or share therein) or, at the party's option, computed in the aggregate.

(2) *Gross income.* (i) Gross income from the operation of agreement vessels means the sum of the revenues which are derived during the taxable year from the following:

(a) Revenues derived from the transportation of passengers, freight, or

mail in such vessels, including amounts from contracts for the charter of such vessels to others, from operating differential subsidies, from collections in accordance with pooling agreements and from insurance or indemnity net proceeds relating to the loss of income attributable to such agreement vessels.

(b) Revenues derived from the operation of agreement vessels relating to commercial fishing activities, including the transportation of fish, support activities for fishing vessels, charters for commercial fishing, and insurance or indemnity net proceeds relating to the loss of income attributable to such agreement vessels.

(c) Revenues from the rental, lease, or use by others of terminal facilities, revenues from cargo handling operations and tug and lighter operations, and revenues from other services or operations which are incidental and directly related to the operation of an agreement vessel. Thus, for example, agency fees, commissions, and brokerage fees derived by the party at his place of business for effecting transactions for services incidental and directly related to shipping for the accounts of other persons are includible in gross income from the operation of agreement vessels where the transaction is of a kind customarily consummated by the party for his own account at such place of business.

(d) Dividends, interest, and gains derived from assets set aside and reasonably retained to meet regularly occurring obligations relating to the shipping or fishing business directly connected with the agreement vessel which obligations cannot at all times be met from the current revenues of the business because of layups or repairs, special surveys, fluctuations in the business, and reasonably foreseeable strikes (whether or not a strike actually occurs), and security amounts retained by reason of participation in conferences, pooling agreements, or similar agreements.

(ii) The items of gross income described in subdivision (i) (c) and (d) of this subparagraph shall be considered to be derived from the operations of a particular agreement vessel in the same proportion that the sum of the

items of gross income described in subdivision (i) (a) and (b) of this subparagraph which are derived from the operations of such agreement vessel bears to the party's total gross income for the taxable year from operations described in subdivision (i) (a) and (b) of this subparagraph.

(iii) In the case of a party who uses his own or leased agreement vessels to transport his own products, the gross income attributable to such vessel operations is an amount determined to be an arm's length charge for such transportation. The arm's length charge shall be determined by applying the principles of section 482 of the Code and the regulations thereunder as if the party transporting the product and the owner of the product were not the same person but were controlled taxpayers within the meaning of § 1.482-1(a)(4) of the Income Tax Regulations of this chapter. Gross income attributable to the operation of agreement vessels does not include amounts for which the party is allowed a deduction for percentage depletion under sections 611 and 613 of the Code.

(3) *Deductions.* From the gross income attributable to the operation of an agreement vessel or vessels as determined under subparagraph (2) of this paragraph, there shall be deducted, in accordance with the principles of § 1.861-8 of the Income Tax Regulations of this chapter, the expenses, losses, and other deductions definitely related and therefore allocated and apportioned thereto and a ratable part of any expenses, losses, or other deductions which are not definitely related to any gross income of the party. Thus, for example, if a party has gross income attributable to the operation of an agreement vessel and other gross income and has a particular deduction definitely related to both types of gross income, such deduction must be apportioned between the two types of gross income on a reasonable basis in determining the taxable income attributable to the operation of the agreement vessel.

(4) *Net operating and capital loss deductions.* The taxable income of a party attributable to the operation of agreement vessels shall be computed without regard to the carryback of any net

operating loss deduction allowed by section 172 of the Code, the carryback of any net capital loss deduction allowed by sections 165(f) of the Code, or any reduction in taxable income allowed by section 607 of the Act.

(5) *Method of accounting.* Taxable income must be computed under the method of accounting which the party uses for Federal income tax purposes. Such method may include a method of reporting whereby items of revenue and expense properly allocable to voyages in progress at the end of any accounting period are eliminated from the computation of taxable income for such accounting period and taken into account in the accounting period in which the voyage is completed.

(c) *Net proceeds from transactions with respect to agreement vessels.* [Reserved]

(d) *Earnings and gains from the investment or reinvestment of amounts held in a fund—(1) In general.* (i) Earnings and gains received or accrued by a party from the investment or reinvestment of assets in a fund is the total amount of any interest or dividends received or accrued, and gains realized, by the party with respect to assets deposited in, or purchased with amounts deposited in, such fund. Such earnings and gains are therefore required to be included in the gross income of the party unless such amount, or a portion thereof, is not taken into account under section 607(d)(1)(C) of the Act and § 3.3(b)(2)(ii) by reason of a deposit or deemed deposit into the fund. For rules relating to receipts from the sale or other disposition of nonmoney deposits into the fund, see paragraph (g) of this section.

(ii) Earnings received or accrued by a party from investment or reinvestment of assets in a fund include the ratable monthly portion of original issue discount included in gross income pursuant to section 1232(a)(3) of the Code. Such ratable monthly portion shall be deemed to be deposited into the ordinary income account of the fund, but an actual deposit representing such ratable monthly portion shall not be made. For basis of bond or other evidence of indebtedness issued at a discount, see § 3.3(b)(2)(ii)(b).

(2) *Gain realized.* (i) The gain realized with respect to assets in the fund is the

excess of the amount realized (as defined in section 1001(b) of the Code and the regulations thereunder) by the fund on the sale or other disposition of a fund asset over its adjusted basis (as defined in section 1011 of the Code) to the fund. For the adjusted basis of nonmoney deposits, see paragraph (g) of this section.

(ii) Property purchased by the fund (including property considered under paragraph (g)(1)(iii) of this section as purchased by the fund) which is withdrawn from the fund in a qualified withdrawal (as defined in § 3.5) is treated as a disposition to which subdivision (i) of this subparagraph applies. For purposes of determining the amount by which the balance within a particular account will be reduced in the manner provided in § 3.6(b) (relating to order of application of qualified withdrawals against accounts) and for purposes of determining the reduction in basis of a vessel, barge, or container (or share therein) pursuant to § 3.6(c), the value of the property is its fair market value on the day of the qualified withdrawal.

(3) *Holding period.* Except as provided in paragraph (g) of this section, the holding period of fund assets shall be determined under section 1223 of the Code.

(e) *Leased vessels.* In the case of a party who is a lessee of an agreement vessel, the maximum amount which such lessee may deposit with respect to any agreement vessel by reason of section 607(b)(1)(B) of the Act and paragraph (a)(1)(ii) of this section (relating to depreciation allowable) for any period shall be reduced by the amount (if any) which, under an agreement entered into under section 607 of the Act, the owner is required or permitted to deposit for such period with respect to such vessel by reason of section 607(b)(1)(B) of the Act and paragraph (a)(1)(ii) of this section. The amount of depreciation depositable by the lessee under this paragraph is the amount of depreciation deductible by the lessor on its income tax return, reduced by the amount described in the preceding sentence or the amount set forth in the agreement, whichever is lower.

(f) *Definition of agreement vessel.* For purposes of this section, the term “agreement vessel” (as defined in

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§ 3.11(a)(3) and 46 CFR 390.6) includes barges and containers which are the complement of an agreement vessel and which are provided for in the agreement, agreement vessels which have been contracted for or are in the process of construction, and any shares in an agreement vessel. Solely for purposes of this section, a party is considered to have a “share” in an agreement vessel if he has a right to use the vessel to generate income from its use whether or not the party would be considered as having a proprietary interest in the vessel for purposes of State or Federal law. Thus, a partner may enter into an agreement with respect to his share of the vessel owned by the partnership and he may make deposits of his distributive share of the sum of the four subceilings described in paragraph (a)(1) of this section. Notwithstanding the provisions of subchapter K of the Code (relating to the taxation of partners and partnerships), the Internal Revenue Service will recognize, solely for the purposes of applying this part, an agreement by an owner of a share in an agreement vessel even though the “share” arrangement is a partnership for purposes of the Code.

(g) *Special rules for nonmoney deposits and withdrawals*—(1) *In general.* (i) Deposits may be made in the form of money or property of the type permitted to be deposited under the agreement. (For rules relating to the types of property which may be deposited into the fund, see 46 CFR § 390.7(d), and 50 CFR part 259.) For purposes of this paragraph, the term “property” does not include money.

(ii) Whether or not the election provided for in subparagraph (2) of this paragraph is made—

(a) The amount of any property deposited, and the fund’s basis for property deposited in the fund, is the fair market value of the property at the time deposited, and

(b) The fund’s holding period for the property begins on the day after the deposit is made.

(iii) Unless such an election is made, deposits of property into a fund are considered to be a sale at fair market value of the property, a deposit of cash equal to such fair market value, and a purchase by the fund of such property

for cash. Thus, in the absence of the election, the difference between the fair market value of such property deposited and its adjusted basis shall be taken into account as gain or loss for purposes of computing the party’s income tax liability for the year of deposit.

(iv) For fund’s basis and holding period of assets purchased by the fund, see paragraph (d) (2) and (3) of this section.

(2) *Election not to treat deposits of property other than money as a sale or exchange at the time of deposit.* A party may elect to treat a deposit of property as if no sale or other taxable event had occurred on the date of deposit. If such election is made, in the taxable year the fund disposes of the property, the party shall recognize as gain or loss the amount he would have recognized on the day the property was deposited into the fund had the election not been made. The party’s holding period with respect to such property shall not include the period of time such property was held by the fund. The election shall be made by a statement to that effect, attached to the party’s Federal income tax return for the taxable year to which the deposit relates, or, if such return is filed before such deposit is made, attached to the party’s return for the taxable year during which the deposit is actually made.

(3) *Effect of qualified withdrawal of property deposited pursuant to election.* If property deposited into a fund, with respect to which an election under subparagraph (2) of this paragraph is made, is withdrawn from the fund in a qualified withdrawal (as defined in § 3.5) such withdrawal is treated as a disposition of such property resulting in recognition by the party of gain or loss (if any) as provided in subparagraph (2) of this paragraph with respect to nonfund property. In addition, such withdrawal is treated as a disposition of such property by the fund resulting in recognition of gain or loss by the party with respect to fund property to the extent the fair market value of the property on the date of withdrawal is greater or less (as the case may be) than the adjusted basis of the property to the fund on such date. For purposes of determining the amount by which

the balance within a particular account will be reduced in the manner provided in §3.6(b) (relating to order of application of qualified withdrawals against accounts) and for purposes of determining the reduction in basis of a vessel, barge, or container (or share therein) pursuant to §3.6(c), the value of the property is its fair market value on the day of the qualified withdrawal. For rules relating to the effect of a qualified withdrawal of property purchased by the fund (including deposited property considered under subparagraph (1)(iii) of this paragraph as purchased by the fund), see paragraph (d)(2)(ii) of this section.

(4) *Effect of nonqualified withdrawal of property deposited pursuant to election.* If property deposited into a fund with respect to which an election under subparagraph (2) of this paragraph is made, is withdrawn from the fund in a nonqualified withdrawal (as defined in §3.7(b)), no gain or loss is to be recognized by the party with respect to fund property or nonfund property but an amount equal to the adjusted basis of the property to the fund is to be treated as a nonqualified withdrawal. Thus, such amount is to be applied against the various accounts in the manner provided in §3.7(c), such amount is to be taken into account in computing the party's taxable income as provided in §3.7(d), and such amount is to be subject to interest to the extent provided for in §3.7(e). In the case of withdrawals to which this subparagraph applies, the adjusted basis of the property in the hands of the party is the adjusted basis on the date of deposit, increased or decreased by the adjustments made to such property while held in the fund, and in determining the period for which the party has held the property there shall be included, in addition to the period the fund held the property, the period for which the party held the property before the date of deposit of the property into the fund. For rules relating to the basis and holding period of property purchased by the fund (including deposited property considered under subparagraph (1)(ii) of this paragraph as purchased by the fund) and withdrawn in a nonqualified withdrawal see §3.7(f).

(5) *Examples.* The provisions of this paragraph are illustrated by the following examples:

*Example (1).* X Corporation, which uses the calendar year as its taxable year, maintains a fund described in §3.1. X's taxable income (determined without regard to section 607 of the Act) is \$100,000, of which \$80,000 is taxable income attributable to the operation of agreement vessels (as determined under paragraph (b)(1) of this section). Under the agreement, X is required to deposit into the fund all earnings and gains received from the investment or reinvestment of amounts held in the fund, an amount equal to the net proceeds from transactions referred to in §3.2(c), and an amount equal to 50 percent of its earnings attributable to the operation of agreement vessels provided that such 50 percent does not exceed X's taxable income from all sources for the year of deposit. The agreement permits X to make voluntary deposits of amounts equal to 100 percent of its earnings attributable to the operation of agreement vessels, subject to the limitation with respect to taxable income from all sources. The agreement also provides that deposits attributable to such earnings may be in the form of cash or other property. On March 15, 1973, X deposits, with respect to its 1972 earnings attributable to the operation of agreement vessels, stock with a fair market value at the time of deposit of \$80,000 and an adjusted basis to X of \$10,000. Such deposit represents agreement vessel income of \$80,000. At the time of deposit, such stock had been held by X for a period exceeding 6 months. X does not elect under subparagraph (2) of this paragraph to defer recognition of the gain. Accordingly, under subparagraph (1)(iii) of this paragraph, the deposit is treated as a deposit of \$80,000 and X realizes a long-term capital gain of \$70,000 on March 15, 1973.

*Example (2).* The facts are the same as in example (1), except that X elects in accordance with subparagraph (2) of this paragraph not to treat the deposit as a sale or exchange. On July 1, 1974, the fund sells the stock for \$85,000. The basis to the fund of the stock is \$80,000 (see subparagraph (1)(ii) (a) of this paragraph). With respect to nonfund property, X recognizes \$70,000 of long-term capital gain on the sale includible in its gross income for 1974. With respect to fund property, X realizes \$5,000 of long-term capital gain (the difference between the amount received by the fund on the sale of the stock, \$85,000, and the basis to the fund of the stock, \$80,000), an amount equal to which is required to be deposited into the fund with respect to 1974, as a gain from the investment or reinvestment of amounts held in the

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fund. Since the fund held the stock for a period exceeding 6 months, the \$5,000 is allocated to the fund's capital gain account under § 3.4(c).

*Example (3).* The facts are the same as in example (2), except that the fund sells the stock on July 1, 1974, for \$75,000. As the basis to the fund of the stock is \$80,000, with respect to fund property, X realizes a long-term capital loss on the sale (the difference between the amount received by the fund on the sale of the stock, \$75,000, and the basis to the fund of the stock, \$80,000), of \$5,000, an amount equal to which is required to be charged against the fund's capital gain account under § 3.4(e). Under subparagraph (2) of this paragraph, X recognizes \$70,000 of long-term capital gain with respect to nonfund property on the sale which is includible in its gross income for 1974.

*Example (4).* The facts are the same as in example (2), except that on July 1, 1974, X makes a qualified withdrawal (as defined in § 3.5(a)) of the stock and uses it to pay indebtedness pursuant to § 3.5(b). On the disposition by X considered to occur under subparagraph (3) of this paragraph on the qualified withdrawal, X recognizes \$70,000 of long-term capital gain with respect to nonfund property, which is includible in its gross income for 1974, and a long-term capital gain of \$5,000 with respect to fund property, an amount equal to which is allocated to the fund's capital gain account under § 3.4(c). The fund is treated as having a qualified withdrawal of an amount equal to the fair market value of the stock on the day of withdrawal, \$85,000 (see subparagraph (3) of this paragraph). In addition, \$85,000 is applied against the various accounts in the order provided in § 3.6(b). The basis of the vessel with respect to which the indebtedness was incurred is to be reduced as provided in § 3.6(c).

*Example (5).* The facts are the same as in example (2), except that X withdraws the stock from the fund in a nonqualified withdrawal (as defined in § 3.7(b)). Under subparagraph (4) of this paragraph, X recognizes no gain or loss with respect to fund or nonfund property on such withdrawal. An amount equal to the basis of the stock to the fund (\$80,000) is applied against the various accounts in the order provided in § 3.7(c), and is taken into account in computing X's taxable income for 1974 as provided in § 3.7(d). In addition, X must pay interest on the withdrawal as provided in § 3.7(e). The basis to X of the stock is \$10,000 notwithstanding the fact that the fair market value of such stock was \$85,000 on the day of withdrawal (see subparagraph (4) of this paragraph).

#### § 3.3 Nontaxability of deposits.

(a) *In general.* Section 607(d) of the Act sets forth the rules concerning the

income tax effects of deposits made with respect to ceilings described in section 607(b) and § 3.2. The specific treatment of deposits with respect to each of the subceilings is set forth in paragraph (b) of this section.

(b) *Treatment of deposits—(1) Earnings of agreement vessels.* Section 607(d)(1)(A) of the Act provides that taxable income of the party (determined without regard to section 607 of the Act) shall be reduced by an amount equal to the amount deposited for the taxable year out of amounts referred to in section 607(b)(1)(A) of the Act and § 3.2(a)(1)(i). For computation of the foreign tax credit, see paragraph (i) of this section.

(2) *Net proceeds from agreement vessels and fund earnings.* (i)(a) Section 607(d)(1)(B) provides that gain from a transaction referred to in section 607(b)(1)(C) of the Act and § 3.2(a)(1)(iii) (relating to ceilings on deposits of net proceeds from the sale or other disposition of agreement vessels) is not to be taken into account for purposes of the Code if an amount equal to the net proceeds from transactions referred to in such sections is deposited in the fund. Such gain is to be excluded from gross income of the party for the taxable year to which such deposit relates. Thus, the gain will not be taken into account in applying section 1231 of the Code for the year to which the deposit relates.

(b) [Reserved]

(ii)(a) Section 607(d)(1)(C) of the Act provides that the earnings (including gains and losses) from the investment and reinvestment of amounts held in the fund and referred to in section 607(b)(1)(D) of the Act and § 3.2(a)(1)(iv) shall not be taken into account for purposes of the Code if an amount equal to such earnings is deposited into the fund. Such earnings are to be excluded from the gross income of the party for the taxable year to which such deposit relates.

(b) However, for purposes of the basis adjustment under section 1232(a)(3)(E) of the Code, the ratable monthly portion of original issue discount included in gross income shall be determined without regard to section 607(d)(1)(C) of the Act.

(iii) In determining the tax liability of a party to whom subparagraph (1) of